The Swedish Model in Turbulent Times: Decline or Renaissance

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Abstract

The main objective of this paper is to analyze the major transformations of the Swedish model. The changes during the 1990s toward a more restrictive and anti-inflationary macroeconomic policy, the reorientation of active labor market policies toward supply-oriented measures, and the structural reforms undertaken in the social protection systems suggest a *revival and renaissance of the traditional Swedish model.* The Swedish welfare state remains clearly universal and inclusive in nature and still enjoys a high level of public support. In our view, these developments reinforce the coherence of the Swedish model and the robustness of its social cohesion.

Introduction

By any international standards, Sweden has, up to the end of the 1980s, been remarkably successful in combining low unemployment with not only high and growing employment rates but also low income dispersion and small gender disparities. However, most economists and many policy makers were aware that the unprecedented activity level and the extreme labor market tightness during the second half of the 1980s were in the long run not sustainable. In the early 1990s the Swedish economy experienced the most dramatic crisis since the early 1930s. In just three years—from 1990 to 1993—the rate of open unemployment quintupled from less than 2 to more than 8 percent of the labor force. By contrast, from the second half of the 1990s the Swedish economy has undergone a particularly favorable development: gross domestic product (GDP) growth rates have returned to early 1970s levels; unemployment has been cut by half; there have been large balance-of-trade surpluses; and public finances have improved substantially. During the last decade, in strong contrast with the 1980s, the Swedish economy has also experienced low inflation.

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It has been argued that what Sweden endured in the early 1990s demonstrates that the original "Swedish model" had become "time inconsistent" in the sense that it was destined to give rise to developments incompatible with its long-term sustainability. However, such interpretations give rise to some critical questions. Is it true that "the traditional," original model elaborated during the 1950s has succumbed and that a fundamentally different, more coherent and sustainable model has today emerged? What are the main differences between the current national model, the original model, and the one that prevailed during the period 1975–1990?

1. The Origin, Rise, and Decline of the Swedish Model

The "Traditional Model"

From its creation in the early 1950s up to the mid-1970s, the traditional Swedish model was based on three fundamental components:

1. A restrictive fiscal and monetary policy aiming at curbing the rate of inflation in a regime of fixed exchange rates. Such an anti-inflationary policy should be complemented by policy measures aiming at preserving "full and productive employment"
2. A centralized and coordinated wage bargaining system and the application of a wage norm, the so called solidaristic wage policy based on equity (equal pay for equal work) and efficiency (that is, fostering rationalization at the company level and promoting productivity-enhancing structural changes through closure of unproductive plants)
3. The implementation of an ambitious countercyclical active labor market policy (ALMP) favoring occupational and geographical mobility and enhancing employment opportunities for those with reduced work capacity

It goes without saying that the overall macroeconomic policies, while being restrictive enough to prevent inflationary pressures, should be expansionary enough to secure both employment growth and a low unemployment rate. Low unemployment should be secured mainly by ALMP programs favoring a reallocation of the labour force from the declining parts of the economy[1] toward the expanding ones. Such a model or policy strategy, often referred to as "the *Rehn-Meidner Model,*"[2] presupposed the existence of powerful and autonomous employees' and employers' organizations and a high degree of consensus/cooperation between them and also between the two sides of industry and the government. The *solidaristic wage policy* involved not only the application of the equity principle of "equal pay for equal work" (irrespective of individual firms' profitability, industries, or regions) but also became an instrument for reducing wage differentials within occupations—that is, to promote a more compressed wage structure.

The policies pursued, based on a strong political commitment to the goal of full employment and to egalitarian ideals, resulted in a remarkably low unemployment rate. Furthermore, by international standards, Sweden stood out as rather successful in terms of labor market participation, gender equal opportunity, egalitarian income distribution and—disregarding the period from the mid-1970s to the early 1980s—sustained economic growth. To a considerable extent the good employment records experienced during this period were also related to an expansion of public employment and the creation of a modern welfare state, implying a strong public involvement in the financing and provision of health care, social care, and education.

Early Warnings: The Crisis of the Late 1970s and Deviations from the Original Model

Actually, the Swedish economy started to show serious signs of weakness long before the dramatic economic downturn and employment crisis of the early 1990s. In fact, from the mid-1970s the worsening of Sweden's macroeconomic performances in the wake of the two oil crises, a restrictive economic policy in major Organization for Economic Co-operation and Development (OECD) countries, and the intensified competition from Japan, Korea, and the Newly Industrialized Countries (NIC), was met by means of extraordinary policy interventions, notably devaluations of the Swedish currency, implying apparent deviations from the policies prescribed by the model per se. The repeated devaluations carried out in the late 1970s and early 1980s were also the reflection of the inability of the social partners to achieve a wage development compatible with the preservation of macroeconomic balance and the maintenance of international competitiveness of Swedish companies in a regime of fixed exchange rates. The "cost" and "deficit" and "structural" crises of the late 1970s were, however, never translated into a severe "employment" crisis, due in particular to the massive expansion of employment in the public sector. The social insurance systems remained intact, and the public (especially the municipal) provision of health and social care was in fact expanded.

The Crisis of the Early 1990s

By contrast, the crisis of the early 1990s took the form of a dramatic *employment* crisis. Why was this allowed to happen, and what are the main factors explaining the sharp increase of unemployment? Why was the emerging cost crisis, which was clearly observable well before 1990, not met by "over-bridging" and devaluation policies similar to those implemented during the previous decades?

The use of an accommodative monetary policy as a means of combating excessive “home-made” inflation, which reached 11 percent in 1990, was unanimously rejected. The common understanding was that the country could not afford a repetition of what happened in the late 1970s and early 1980s. The center-right government in power from 1991 to 1994 tried to counteract the devaluation expectations by means of restrictive fiscal policy involving substantial reductions in public spending, and it was in this respect supported by the social democrats now in opposition after having taken some steps in the same direction before losing the election in 1991. However, these policies, in combination with the original cost crisis and the high interest rates, resulted in soaring unemployment, decreasing public revenues, and—in spite of the cutbacks of public expenditures—a rapidly increasing budget deficit. Apparently, many actors on the international financial markets came to the conclusion that Sweden would, as in the past, soon devaluate. The attempts to defend the Swedish currency had thus resulted in reinforcing the devaluation expectations! In November 1992 the central bank had to allow the Swedish Krona to float. It became immediately depreciated by about 20 percent.

Needless to say, the policy failures behind the crisis of the early 1990s became extremely costly for Swedish citizens. Between 1990 and 1993 the Swedish GDP decreased by 5 percent. The consequences were especially painful for vulnerable groups hit by unemployment and/or by the reductions in social benefits and public commitments that became elements of the emergency measures carried out.

Since 1994 the macroeconomic and labor market conditions have improved in many ways. The central bank has been, on the whole, rather successful in fulfilling its task to keep a low inflation rate and to uphold its independence and autonomy vis-à-vis the government and the Swedish Parliament (*Riksdag*). By early 2001 the budget deficit had turned into a surplus. Between 1993 and 2000 GDP yearly growth rate was on average 3.2 percent. This relatively rapid growth reflects a substantial increase in exports fostered by the depreciation of the Swedish currency and wage moderation. The rate of unemployment remained above 8 percent until 1997, but by 2002 it had declined to about 4 percent.

2. The Recent Transformations of the Swedish Model

Reorientation of Macroeconomic Policy

The devaluations in the late 1970s and early 1980s, and the deep crisis of the early 1990s, demonstrate that the policies pursued, in particular the lack of an institutionalized anti-inflationary mechanism, involved strong elements of time inconsistency. According to the traditional model developed in the 1950s, the macroeconomic policies should be restrictive to keep the inflation at a level consistent with a fixed foreign exchange rate regime.

The reorientation of monetary and fiscal policy started in 1993 with the establishment of an inflation target, the fulfilment of which became the autonomous central bank's main objective.[3] The Swedish currency was allowed to float. Consequently, the government and the two sides of industry have to consider the fact that the autonomous and independent central bank will react to inflationary fiscal policies or excessive wage increases by increasing its interest rates and thus decreasing employment. This new division of roles and responsibilities between the government and the central bank means that the anti-inflationary policies prescribed by the Rehn-Meidner model have been institutionalized in a way that precludes the kinds of inflation-generating policy failures observed in the late 1970s and late 1980s. These new developments represent, in our view, a *strengthening of,* rather than a deviation from, the traditional Swedish model.

Active Labor Market Policies

Sweden's excellent record on employment and unemployment has often been ascribed to a particularly ambitious ALMP. The ALMP has played a vital role in Swedish stabilization policies since the late 1950s and constitutes, as mentioned previously, one of the corner stones of the Swedish model. ALMP programs have been used not only to promote an efficient allocation of resources and facilitate transitions from unemployment to employment but also to favor the integration of marginal workers—for example, the disabled—who without public intervention would have been excluded from the labor force. Two key and distinctive features of Swedish employment policy may be identified: on the one hand, the public authorities wish to put the accent on measures promoting the integration of unemployed workers instead of passive support (that is, activation); on the other hand, the two sides of industry are given a key role in the design and implementation of ALMP programs, thereby insuring its social legitimacy.

The early 1990s also saw a reorientation of the ALMP emphasizing measures designed to improve matching efficiency and develop occupational and geographical mobility. The number of participants in vocational training programs and/or practical insertion courses rose quickly, while traditional measures focusing on labor demand remained at a much lower level than during previous recessions. The growing role of vocational training in the ALMP is therefore evidence of the importance that the government and the social partners give to occupational mobility and to the development of skills over the life course. In our view, the reorientation of ALMP in the early 1990s toward more supply-oriented programs can be considered as a *retour au source* to the initial conception of ALMP interventions that better meet the increasing demand for skill upgrading and occupational mobility.

Transformations of Industrial Relations

For more than twenty-five years (1955–1982) the third important component of the traditional model has been a wage formation process based on a centralized and coordinated bargaining system. In 1983 the Engineering Employers' Organisation concluded a separate agreement with the Metal Workers' Union, departing from over two decades of a centralized and coordinated bargaining system. The combination of the abandonment of interprofessional agreements, the erosion of the Swedish model of industrial relations—in particular the weakening of mechanisms for coordinating collective bargaining—and the resurgence of industrial disputes during the 1980s led the social partners to formulate new strategies in the early 1990s.

While the conjunction of several factors explains the "Swedish Success Story," there are strong reasons to believe that changes in the Swedish industrial relations system that occurred in the mid-1990s, in particular the changes in the regulation of collective bargaining and wage formation, have played an important role in this development. Although these changes show that the two sides of industry are nowadays prone to accept a re-coordination of industry-wide agreements and give the traded goods sector a leadership role in wage determination, it would be erroneous to interpret these new tendencies as a weakening of enterprise-level bargaining. In fact, industry-wide agreements leave ample scope for enterprise-level negotiations, particularly regarding the distribution of the individualized part of the wage increase negotiated and concluded at industry level. Strong trade union organizations and high union density at the company level ensure the implementation of negotiated forms of individualization and differentiation. In our view, this two-tier system provides an institutional and legal framework that is favorable to the emergence of *negotiated flexibility.*

Transformation of the Social Protection System

The various reforms of the Swedish social protection system undertaken during the last decade have essentially taken the form of a temporary reduction of the income replacement rate and, with perhaps the exception of the fundamental restructuring of the tax and pension system, have left the Swedish welfare state system almost intact. The Swedish social protection system remains, by international standards, clearly universal and inclusive in nature and still enjoys a high level of public support. The profound reshaping of the pension system and the tax reform initiated in the early 1990s aimed at strengthening work incentives, increasing labor force participation, and fostering investment in human capital are also clearly in line with the general philosophy of the original Swedish model favoring integrative transitions instead of passive support and social exclusion.

Conclusion

The present Swedish model appears today more in line with the three core components of the original model developed and implemented during the 1950s and 1960s. The recent changes in economic policy toward more restrictive and anti-inflationary macroeconomic policies, the reorientation of active labor market policies toward supply-oriented measures, and the structural reforms undertaken in the wage formation, tax, and social protection systems suggest a *revival and renaissance* of the traditional Swedish model.

After a period of turbulence in the early 1990s, the Swedish economy has undergone a particularly favorable economic development during the last decade. Unemployment has been cut by half, inflation has been curbed, and the country appears to have recovered from the deep economic crisis of the early 1990s. Besides the reorientation of macroeconomic and employment policy, the recent modifications in Swedish industrial relations, in particular the clear tendency toward a re-coordination of wage bargaining, have without doubt played a vital role in the Swedish recovery. These new developments reflect a desire on the two sides of industry to re-coordinate collective bargaining at the industry level and to restore the leading role of the traded goods sector in wage formation. Sweden's various bipartite cooperation agreements concluded during the late 1990s may be interpreted as a new historic compromise combining employers' demands for greater flexibility with a desire on the part of the trade union movement to restore full employment and sustained income growth.

Last but not least, the third main element of the Rehn-Meidner model—the extensive use of ALMPs, that is, the overall *policy of activation*—still occupies a central role in Swedish stabilization policy, and its reorientation toward supply-oriented measures (occupational and geographical mobility, active search programs, etc.) in many respects stands out as well in accordance with the strategy initiated in the 1950s.

Overall, the recent modifications of the Swedish model creates an institutional framework favorable to the emergence of negotiated flexibility and a return to balanced economic and employment growth. In our view, these developments reinforce the coherence of the Swedish model and the robustness of its social cohesion.

Notes

The present contribution is a revised and shortened version of D. Anxo and H. Niklasson, "The Swedish Model in Turbulent Times: Decline or Renaissance?" *International Labour Review* 145, no. 4 (2006).

1. Where firms with relatively low productivity tend to disappear or reduce their labor force due to the application of the solidarity wage policy.

2. The Swedish model was initially formulated by the two Swedish economists Gösta Rehn and Rudolf Meidner, both employed at the Swedish Confederation of blue collar workers, LO.

3. The inflation target amounts to a 2 percent rise per year in the consumer price index, within a corridor of plus or minus 1 percent.